

This Order has been published by the NASDR Office of Hearing Officers and should be cited as OHO Order 99-10 (C8A990015).

**NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

Respondents.

Disciplinary Proceeding
No. C8A990015

Hearing Officer—Andrew H. Perkins

**ORDER GRANTING IN PART AND DENYING IN PART
COMPLAINANT'S MOTION TO STRIKE AFFIRMATIVE DEFENSES**

The Department of Enforcement (Enforcement) moved to strike two of the Respondents' affirmative defenses. For the reasons set forth below, Enforcement's motion to strike the affirmative defense that the charges are barred by the statute of limitations is granted, and Enforcement's motion to strike the defense that the charges are barred by the doctrine of laches is denied.

I. Introduction

_____ is charged with selling 33 securities in contravention of NASD Conduct Rule 2110 and IM-2110-1, which prohibit the sale to persons associated with any broker-dealer of

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securities of a public offering which trade at a premium in the secondary market (“hot issues”).

The complaint alleges that the sales occurred during the period from in or about September 1993 through in or about April 1996. _____, in turn, is charged with violating NASD Conduct Rules 2110 and 3010 for failing to enforce supervisory procedures and failing reasonably to supervise _____ by failing to prevent 19 of the above trades. In their Answers, _____ and _____ deny each of the allegations against them and raise a number of affirmative defenses.

Enforcement urges the Hearing Officer to strike two of these affirmative defenses. Enforcement argues that their defenses asserting that the charges in the Complaint are barred by the statute of limitations and the doctrine of laches are legally insufficient, and, therefore, it would waste time and resources if the Respondents are permitted to present evidence in their support at the hearing.

II. *Facts*

The Complaint contains the following allegations, which are not findings of fact by the Hearing Officer. _____ and _____ were registered with the National Association of Securities Dealers, Inc. (“NASD”) during the periods relevant to this proceeding.¹ Between early 1988 and 1995, _____ opened three securities accounts for persons associated with broker-dealers registered with the Securities Exchange Commission (“SEC”).² From September 1993 to April 1996, _____ effected or caused to be effected 33 purchases of 33 securities for these accounts.³ All of these purchases were securities of initial public offerings at their initial public offering

¹ Compl. ¶¶ 1, 2.

² *Id.* ¶¶ 3, 4, 5.

³ *Id.* ¶ 6.

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prices. Enforcement alleges that these were hot issues and that their sale by _____ to associated persons violated NASD Conduct Rule 2110 and IM-2110-1.⁴

Between September 1993 through July 1995, _____ failed to reasonably supervise _____ and failed to prevent _____ from effecting 19 of the above-mentioned trades.⁵

Enforcement alleges that _____ thereby violated NASD Conduct Rules 2110 and 3010.⁶

III. *Enforcement's Motion to Strike*

A. *Legal Standards for Motions to Strike Affirmative Defenses*

Because the NASD Code of Procedure does not specifically address motions to strike, it is appropriate for the Hearing Officer to be guided by the standard in the Federal Rules of Civil Procedure (Fed. R. Civ. P.). In federal court, motions to strike affirmative defenses are governed by Fed. R. Civ. P. 12(f), which provides that the court may strike any insufficient defense from any pleading. Courts, however, generally disfavor Fed. R. Civ. P. 12(f) motions and do not grant them routinely.⁷ This is true in part because often they are filed as a dilatory tactic.⁸ The generally favored policy is that pleadings should be treated liberally and that parties should be given the opportunity to be heard on their contentions.⁹

Before a federal court will grant a motion to strike affirmative defenses, it must be

⁴ Id. ¶ 7.

⁵ Id. ¶ 8.

⁶ Id. ¶ 9.

⁷ See, e.g., New York v. Almy Brothers, Inc., 971 F. Supp. 69, 72 (N.D.N.Y. 1997).

⁸ See, e.g., Oliner v. McBride's Industries, Inc., 106 F.R.D. 14, 17 (S.D.N.Y. 1985).

⁹ Id.

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convinced of the following: (1) there is no question of fact which might allow the defense to succeed; (2) there is no substantial question of law; and (3) there is prejudice to the opposing party from inclusion of the defense.¹⁰ To be stricken, the affirmative defense asserted must be clearly insufficient as a matter of law.¹¹ Further, the grounds for the motion must appear on the face of the pleading or from a matter the federal court may judicially notice.¹²

B. *Analysis*

1. *Statute Of Limitations*

Respondents assert that the claims against them should be barred by 28 U.S.C. § 2462, a statute of limitations providing that a proceeding for the enforcement of any civil fine or penalty must be commenced within five years from the date when the claim first accrued.¹³ Enforcement argues that the defense pertaining to the statute of limitations is legally insufficient and should be stricken from the case because the NASD Rules do not limit the initiation of a disciplinary proceeding, provided that the NASD still has jurisdiction over the respondent.¹⁴

Respondents challenge this motion, asserting that 28 U.S.C. § 2462 should apply to

¹⁰ See, e.g., *Almy*, 971 F. Supp. at 72.

¹¹ See, e.g., *Oliner*, 106 F.R.D. at 17. Cf. *Matter of Thorn, Welch & Co., Inc* Admin.Proc. File No. 3-8400, 57 S.E.C. Docket 2147, 1994 SEC LEXIS 3252, at *2 (Oct. 13, 1994) (motion to strike may be granted if an affirmative defense would not constitute a valid defense under any facts proved).

¹² See, e.g., *SEC v. Sands* 902 F. Supp. 1149, 1165 (C.D. Cal. 1995).

¹³ _____ Ans. at 18; _____ Ans. ¶ 9(f).

¹⁴ Motion to Strike at 2.

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NASD disciplinary proceedings.¹⁵ For support, _____ points to Johnson v. SEC,¹⁶ a 1996 case in which a court vacated an SEC order imposing sanctions on the grounds that more than five years had elapsed between the events and the filing of charges.¹⁷ _____ argues that because the NASD exercises its disciplinary authority subject to SEC review and approval pursuant to Section 19 of the Securities Exchange Act of 1934, the statute of limitations should likewise apply to the NASD.¹⁸

The SEC, however, has foreclosed that argument, and Respondents concede that the federal courts have not applied 28 U.S.C. § 2462 to NASD disciplinary proceedings. In decisions issued after the decision in Johnson v. SEC, the SEC held that 28 U.S.C. § 2462 does not apply to disciplinary proceedings initiated by self-regulatory organizations, such as the NASD.¹⁹ The reasoning behind these holdings is clear. The SEC stated that “there is no requirement in the federal securities laws or the NASD’s rules that there be such a statute of limitations ... [because] the imposition of a limitations period ... would impair the NASD’s statutory obligation and duty to protect the public and discipline its members.”²⁰

¹⁵ _____ concedes that Enforcement’s motion to strike his affirmative defense based on 28 U.S.C. § 2462 “has some merit under current Securities Exchange Commission decisions,” but states his intent to challenge those decisions on appeal if he does not prevail at the hearing in this proceeding.

¹⁶ See Johnson v. SEC, 87 F.3d 484 (D.C. Cir. 1996).

¹⁷ Respondent _____ Opposition to Motion to Strike at 5.

¹⁸ Id. at 6.

¹⁹ See Matter of Henry James Faragalli, Jr., Exchange Act Release No. 37991, 63 S.E.C. Docket 651, 1996 SEC LEXIS 3263, at *36 (Nov. 26, 1996); In re Larry Ira Klein, Exchange Act Release No. 37835, 1996 SEC LEXIS 2922 (Oct. 17, 1996).

²⁰ In re Frederick C. Heller, Exchange Act Release No. 31696, 1993 SEC LEXIS 14, at *10 (Jan. 7, 1993).

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Accordingly, Enforcement's motion to strike the Respondents' affirmative defenses that the charges in the Complaint are barred by the statute of limitations, 28 U.S.C. § 2462, is granted. The affirmative defense is clearly insufficient as a matter of law.

2. *Laches*

Respondents also assert that the charges against them are barred by the doctrine of laches.²¹ In order to prevail on this defense, the Respondents must show both a lack of diligence on the part of the NASD and resulting prejudicial harm.²² The SEC has stated that the NASD's rules do not limit the time within which proceedings may be brought.²³ However, generally, if the party raising the defense can show that it was prejudiced by the other party's delay in raising the claim, laches may be found.²⁴

Respondents assert that the doctrine of laches recognizes that a defense to a claim is substantially impaired if not prosecuted within a reasonable period of time.²⁵ Respondents further assert that the investigation of this matter, and the filing of the complaint, took an unreasonable amount of time, during which key witnesses became unavailable, therefore causing them prejudicial harm. Accordingly, they argue that the delay and prejudicial harm precludes the

²¹ _____ Ans. at 18; _____ Ans. ¶ 9(g).

²² Klien at 20.

²³ See In re Howard Alweil, Exchange Act Rel. No. 31278, Admin Proc. File No. 3-6981, 1992 SEC LEXIS 2576, at *5 (Oct. 1, 1992).

²⁴ See Burka v. Aetna Life Ins. Co., 56 F.3d 1509, 1514 (D.C. Cir. 1995) (property dispute in which the doctrine of laches defense was not stricken when relevant issues of fact remained). See also Rhode Island Preservation Fund Inc. v. Southhold Development Corp., 959 F.2d 409, 423-24 (2d Cir.) cert. denied 113 S. Ct. 603 (1992).

²⁵ Respondent _____ Opp'n to Mot. to Strike Affirmative Defenses at 3.

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imposition of charges against them. Respondents also argue that laches is an inherently factual defense and, since several of the facts surrounding both the reasonableness of the delay and the existence of prejudicial harm are in question, it cannot be stricken at this point in the proceeding.²⁶

On the other hand, Enforcement argues that the Respondents cannot show a lack of diligence on its part. Enforcement asserts that it commenced the investigation immediately upon learning of the alleged violations and completed it in a timely fashion. Further, Enforcement asserts that Respondents suffered no prejudice as a result of the lapse of time because the free-riding and withholding violations are self-evident and provable by documents alone.²⁷

The SEC has recognized that laches may constitute a valid affirmative defense under limited circumstances, and it has therefore refused to strike the defense of laches from the pleadings, regarding it as a factual question to be resolved at the hearing.²⁸ In this case, there appear to be substantial questions of fact that—if proven—might allow the Respondents to show such a degree of prejudice that their right to a fair hearing has been fundamentally impaired. Consequently, the Hearing Officer cannot conclude that their affirmative defense of laches should be stricken at this early stage of the proceeding.²⁹ There are substantial factual questions left to be resolved, and striking the affirmative defense at this early stage would be premature.

²⁶ Id. at 3-4.

²⁷ Motion to Strike at 6.

²⁸ See In re Piper Capital Management, Inc. Administrative Proceedings File No. 3-9657, 1999 SEC LEXIS 301, at *8 (Jan. 15, 1999) (“Respondent should not be denied the opportunity to demonstrate qualifying circumstance ~~See~~; also In re Dean Witter Reynolds Inc. Administrative Proceedings File No. 3-9686, 1999 SEC LEXIS 762, at *2 (Feb. 12, 1999) (finding it inappropriate to strike an affirmative defense of laches before evidence was adduced).

²⁹ See Burka at 1514 (decision as to whether delays are unreasonable turns on facts).

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Therefore, Enforcement's motion to strike the Respondents' affirmative defense based on the doctrine of laches is denied.

SO ORDERED.

Andrew H. Perkins
Hearing Officer

Dated: Washington, DC
June 7, 1999